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SUBJECT: UKRAINE CLAIMS VICTORY IN GAS DEAL THAT WILL
REPLACE INTERMEDIARIES RUE AND UHE

REF: A. KYIV 314

- [1](#)B. KYIV 286
- [1](#)C. MOSCOW 367
- [1](#)D. MOSCOW 354

[1](#)1. (SBU) Summary: President Yushchenko and Prime Minister Tymoshenko are both calling the gas deal struck on February 12 in Moscow a victory for Ukraine. Yushchenko and President Putin announced the deal moments before the deadline set by Gazprom to cut off gas supplies to Ukraine expired. Ukraine agreed to pay off a \$1.5 billion debt beginning on February 14, and Yushchenko claimed that Ukraine had successfully fought off attempts by intermediary RosUkrEnergo (RUE) to charge higher prices for gas already delivered. The Gazprom and NaftoHaz leadership announced intentions to replace RUE and UkrHazEnergo (UHE) with new, jointly-owned intermediaries. Whether the move will mark an improvement over RUE/UHE will depend on the GOU's ability to bring transparency and accountability to the new joint ventures, and on its ability to redefine the business model that allowed UHE to siphon off much needed revenue from NaftoHaz. End summary.

Putin, Yushchenko Announce Deal At Deadline

[1](#)2. (SBU) Putin and Yushchenko announced the agreement moments before the Gazprom-imposed deadline for cutting of gas to Ukraine expired (Note: Yushchenko's trip was planned before the latest crisis erupted. End note). Yushchenko announced that Ukraine will begin paying off the debt of \$1.5 billion on Feb. 14. The modalities and time frame for the payback of the debt were not mentioned at the press conference or in subsequent comments by GOU officials.

[1](#)3. (SBU) Yushchenko also announced what Ukrainian officials have been citing as a victory for Ukraine: he claimed that Ukraine will pay 2007 prices (\$130/tcm) for gas delivered in November and December, 2007, and 2008 prices (\$179.5) for gas delivered in January of this year. Prior to Yushchenko's Moscow trip, Prime Minister Tymoshenko had claimed that RUE was demanding that Ukraine pay higher prices for these past gas deliveries (ref A). It is unclear, however, just how accurate Yushchenko's claims are, since during the press conference Putin said Ukraine would also have to pay higher prices for some Russian gas.

Gazprom, NaftoHaz to Replace RUE, UHE

[1](#)4. (SBU) In separate statements to the media, Gazprom CEO

Miller and NaftoHaz Chairman Dubyna both announced that their companies would cooperate to replace RUE and UHE with two new intermediaries. RUE, the sole supplier of central Asian and Russian gas to Ukraine, is owned by Gazprom (50 percent) and Ukrainian businessmen Dmitro Firtash (45 percent) and Ivan Firsun (5 percent), although it is widely believed that the two Ukrainians are front men for Russian and/or Ukrainian interests. Miller and Dubyna said Gazprom and NaftoHaz would each own 50 percent of the new company replacing RUE.

15. (SBU) UHE, in which RUE and NaftoHaz each have a 50 percent stake, is the sole buyer of RUE's gas in Ukraine. It resells it to large industrial companies and to NaftoHaz. Miller and Dubyna said they would replace UHE with another new intermediary in which Gazprom and NaftoHaz would also each own 50 percent.

Replacing RUE, UHE: What Does it Mean?

16. (SBU) The good news is that questionable characters like Firtash and Firsun will be removed from Russian/Ukrainian gas relations (unless they resurface in the new entities, which cannot be ruled out). The new GOU has strongly criticized the existing intermediaries and called for direct relations between NaftoHaz and Gazprom. The new structures will place the two companies into a direct dialog on both gas delivery and gas distribution within Ukraine, which the GOU is touting as a victory.

17. (SBU) At the same time, some commentators have already pointed out that the new setup will give Gazprom a bigger presence in the Ukrainian domestic market, with a 50 percent direct stake in the new domestic intermediary as opposed to a current 25 percent indirect stake in UHE via RUE. In

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reality, however, Gazprom has already exerted far more influence in UHE than its stake in the company would imply.

18. (SBU) It is not yet clear whether the new domestic intermediary will represent, from Ukraine's point of view, an improvement over the existing setup with UHE. Much of NaftoHaz's financial problems directly result from UHE's particular presence in Ukraine. Since the 2006 gas deal was signed, UHE controls the lucrative market with big industrial customers that buy gas in large volumes and tend to pay their bills on time. NaftoHaz has been left with the loss-making business with Ukrainian utilities. Theoretically, NaftoHaz should benefit indirectly and proportionally from UHE's sales to industrial customers because of its stake in UHE, but UHE has yet to pay dividends to NaftoHaz. Ukraine, and NaftoHaz, will gain little if the new intermediary is simply allowed to replicate UHE's business model. The newspaper Kommersant has already reported that the management of UHE is scheduled to head the new intermediary as well.

19. (SBU) It is equally unclear when the new companies will actually replace RUE and UHE. NaftoHaz Chairman Dubyna said RUE will continue to supply gas to Ukraine under previous contracts until the new joint venture companies are established. Dubyna could provide no timeline for RUE and UHE's removal, but Ihor Didenko, first deputy chairman of NaftoHaz, told us that Gazprom has said that the two intermediaries could be replaced by late February or early March. In statements to the press, first deputy PM Turchynov was less optimistic, saying the two could be gone by the end of 2008.

Origins of the Gas Debt

110. (SBU) Details about the composition and origins of the Ukrainian debt are numerous and sometimes contradictory. Tymoshenko, in acknowledging that a debt existed, said it arose because \$1 billion collected by NaftoHaz in the last

three months of 2007 had not been forwarded to intermediary UHE. The GOU had no documentation explaining where the money went, she said, and she blamed the previous government for its disappearance. Other officials acknowledged that an additional \$500 million accumulated in January.

¶11. (SBU) In his remarks during the joint press conference with Putin, Yushchenko was citing prices for the delivery of central Asian gas. It is well-known, however, that the gas mix supplied by RUE contains Russian gas, for which Ukraine is obliged to pay \$314/tcm. It now appears likely that that the debt arose because RUE had to sell higher-priced Russian gas to Ukraine in the past few months to fulfill its delivery commitments. We understand that RUE has the right to deliver Russian gas, and charge higher prices for it (\$314/tcm), if cheaper gas from central Asia is not available, a point made by Putin during the press conference with Yushchenko. In his discussion with EconOff, however, NaftoHaz's Didenko said Ukraine had not agreed to pay the higher price for Russian gas, and that RUE would have to absorb the losses for any Russian gas it bought from Gazprom at the higher price of \$314/tcm.

¶12. (SBU) It is also not clear why RUE could not deliver enough Central Asian gas to Ukraine. Several sources have argued that Turkmenistan did not fulfill its delivery commitments because of harsh weather there. Turkmenistan has denied this. Others claim that Gazprom, purportedly struggling to service its own market, was using cheap Turkmen gas to meet its own obligations, and charged RUE for more expensive Russian gas while pointing the blame to Turkmenistan. Gazprom CEO Miller, in a weekend telegram to President Yushchenko which contained a concrete threat to cut off gas supplies, said NaftoHaz had withdrawn RUE gas from Ukrainian storage facilities and siphoned off transit gas, forcing RUE to purchase Russian gas to meet its delivery commitments.

Local Reactions

¶13. (SBU) Several Ukrainian interlocutors have questioned whether the deal is really a victory for Ukraine. Energy expert Volodymyr Saprykin from the renowned Razumkov Center for Policy Studies told us he doubted whether RUE and UHE could actually be removed before 2009, and said that the only difference between the RUE/UHE arrangement and the proposed

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Gazprom-NaftoHaz joint ventures seems to be that NaftoHaz might get a bigger share of the Ukrainian domestic market, while Gazprom's shares might decrease. Saprykin also pointed out that no long term contracts were discussed, which could mean more last minute negotiating next year. He also mentioned that Ukraine did not get an increased gas transit fee which Tymoshenko had been pushing for several months, but the issue of transit fees would most likely be a major Ukrainian point for future negotiations with Moscow. Ukrainian Energy Expert Mykhailo Honchar agreed with Hrytsenko and Saprykin in that the players may be changing, but the new arrangement will most likely not be any more transparent. He hoped the governments would make both the former and the present gas agreement contracts public to prove that the new joint ventures are not more of the same murky arrangements.

Comment

¶14. (SBU) It is too early to tell whether the deal is the victory that the Ukrainian political leadership is claiming. The planned replacement of RUE will be good news if Gazprom and NaftoHaz can bring transparency and accountability, both lacking in RUE, to the new intermediary. The existence of a UHE-like intermediary in the domestic market makes little sense in any case, and will be particularly harmful to Ukraine if the new intermediary simply adopts UHE's business

model. The numerous, inconsistent and often contradictory statements made by Ukrainian officials with respect to the gas debt, and their publicly-aired complaints that they don't have full transparency, or proper documentation, for gas deliveries and payments, demonstrate that the GOU still needs to develop and implement a long-term gas strategy vis-a-vis Russia. End comment.
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